

**DEPARTMENT OF REAL ESTATE**

OFFICE OF THE REAL ESTATE COMMISSIONER

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September 13, 2010

**Subject:** Short Sale Fraud Warning For Lenders, Servicers, GSEs, and Other Mortgage Owners and Investors (referred to collectively as "Lenders" and individually as "Lender")

***A Time for Collaboration and Cooperation***

Dear Lender:

With the rise of short sale fraud in California, the Department of Real Estate ("DRE" or the "Department") is reaching out to lenders in an effort to discuss and identify short sale fraud issues, common problems, share information, and ultimately help lenders prevent these types of schemes from being perpetuated. Over the last several months, our Department has received a number of complaints involving short sale transactions where lenders have seemingly been defrauded by real estate licensees and unlicensed companies and persons alike. While investigating these complaints, patterns of activities that are occurring and commonalities among the cases have come to our attention. It is our hope that, by sharing this information with you, a collaborative relationship will be forged to collectively fight against fraudulent schemes targeting lenders and consumers and reign in the yet unknown resulting financial losses.

Despite the nuances of the various short sale fraud ploys, our investigators have noticed some common threads that comprise potentially fraudulent short sale transactions that I would like to share with you.

1. One of the major and recurring schemes is short sale flipping, where real estate agents and brokers have defrauded a short sale lender with respect to the value of a property and purchase offers received, and then, in turn, resold the property for a much higher price. These types of scenarios usually involve a false appraisal or broker price opinion (BPO) that was provided by the listing broker to the short sale lender with the intent of under pricing and falsely stating the value of property. Sometimes, the listing broker will withhold offers from the short sale lender and will only submit one offer from a buyer, or straw buyer, that they have personally secured for the purchase of the property at an artificially low price. Without the knowledge of the short sale lender, the listing broker will then resell the property for a profit, sometimes immediately

after the close of the first transaction as the listing broker already has a buyer lined up at a higher price.

2. Another popular maneuver to defraud the lenders takes the form of undisclosed addenda. In some cases there is an addendum to a purchase agreement that contains conditions of the sale and agreements made between the buyer and seller that are not submitted to short sale lenders with the original purchase contract. One type of addendum that has recently surfaced is one wherein the buyer agrees to pay for the alleged service of a short sale negotiator. The purported service provided by these negotiators is to negotiate with short sale lenders on behalf of sellers which arguably should be the job of the listing broker. Even more disturbing, we have found that many short sale negotiators are, in fact, unlicensed, thereby unlawfully performing real estate services in the State of California. Furthermore, these same negotiators may be affiliated with or confederates of the listing broker, and additional compensation is being paid to the listing broker vis-a-vis the short sale negotiator all without the short sale lender's knowledge. These payments to short sale negotiators are being withheld from short sale lenders altogether and, if financing is obtained, to the buyer's new lender as well.
3. Another variation on the theme of short sale negotiator payments is seen in agreements wherein sellers are crediting buyers with so-called non-recurring closing costs. This credit is then used by the buyer to pay a fee to the short sale negotiator. Whereas the closing cost credit to the buyer is or may be eventually disclosed and approved by the short sale lender, the ultimate payment of that credit to a third party is not. These payments to short sale negotiators often are not divulged on the HUD-1 statement until after the short sale lender has approved all of the terms and the transaction has funded and closed.
4. It should be pointed out that non-recurring closing cost agreements made between buyers and sellers regarding short sale negotiators are also now becoming a reflection of how property are being marketed. DRE is investigating transactions where listing brokers are indicating in their advertisements that only offers where buyers request a non-recurring closing cost credit from the seller to pay for the short sale negotiator fee will be submitted to the short sale lender.
5. The Department has also learned of several occurrences in which buyers and/or sellers are receiving undisclosed monies and credits outside of escrow. These types of

disbursements might also be made possible and facilitated by the escrow company handling the transaction.

All of these incidences of fraud in short sale transactions (which are illustrative and not exhaustive) share the same theme – they revolve around and arise from the knowing failure to disclose material information to the short sale lender. As a result, lenders are approving of sales based on false or omitted information. Our main concern is how can this be stopped?

Consumer complaints and fraud detection have a direct correlation to the market conditions. During these times, consumer complaints about issues involving foreclosures, short sales, and “creative” marketing techniques rise, as do reports of real estate licensee misconduct. Furthermore, real estate activities by unlicensed persons/companies are extremely damaging to the consumer, the industry, and now the lending community. In order for DRE to actively seek the maximum administrative penalties against licensees engaged in short sale fraud and also reduce the risk of financial losses in short sale transactions, we need open channels of communication with lenders to share and report suspicious, unlawful, and/or fraudulent activity. We also need increased cooperation with regard to specific short sale fraud investigations so that DRE can gather, as we are required to do, clear and convincing evidence to a reasonable certainty that a violation of the Real Estate Law has occurred. The way that business is conducted may need to change in order to dry up the flow of short sale schemes.

In closing, let me say that we welcome your feedback, insight, concerns, and reports of possible violations of law at any time. We remain strongly committed to creating a dialogue between our Department and the lenders so that we can combat short sale fraud issues more efficiently and effectively. With multiple avenues of communication and the exchange of information, we aspire to get ahead of the problems and aggressively combat the fraud.

Sincerely,

A handwritten signature in black ink, appearing to read "Jeff Davi". The signature is fluid and cursive, with the first name "Jeff" being more prominent than the last name "Davi".

**Jeff Davi**

California Real Estate Commissioner